Summary Analysis of Private Student Loans

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Purpose of Study

To help educate students on the types and possible outcomes of private student loans, hopefully giving them an advantage when/if they are faced with the decision of what type of loan to choose.

Background

- 1.4 million undergraduate students borrowed private student loans in the 2011-12 calendar year.
- In the 2014-15 calendar year, private student loan debt hit roughly $7.8 billion.
- Total U.S. Student Loan Debt is currently sitting near $1.48 trillion.
- Fixed Rate Loan – A loan that applies the same rate over the entire life of the loan.
- Variable Rate Loan – A loan with a rate that adjusts according to the behavior of an index at specified time intervals.

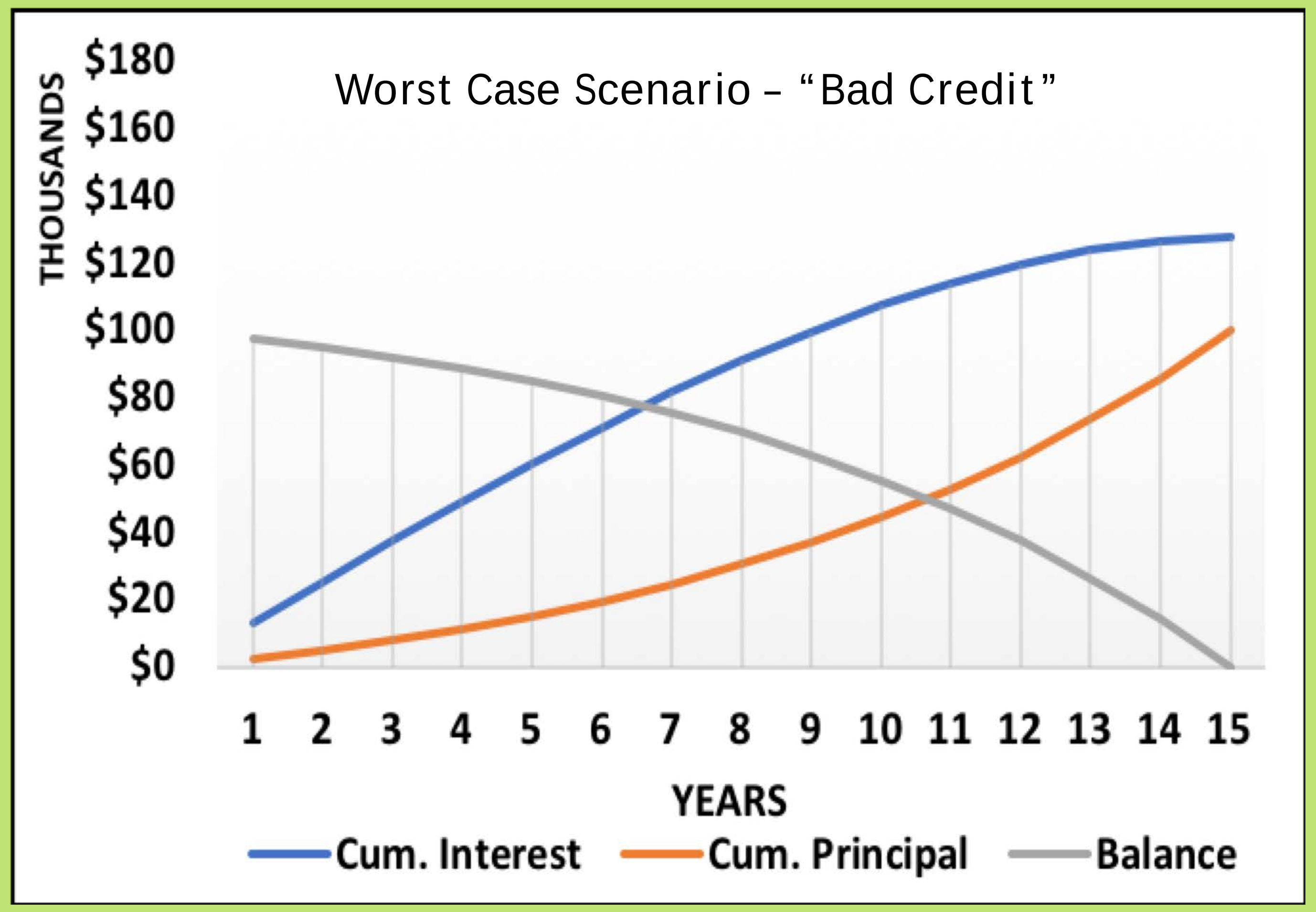
Methodology

- First I took the highest and lowest offered APR for both fixed and variable rate loans, to reflect borrowers with opposite extreme credentials.
- I then created an amortization table using those rates to find the interest and final payoff amount for each scenario.
- Finally, I compared the data to create an analysis of possible outcomes for both options.

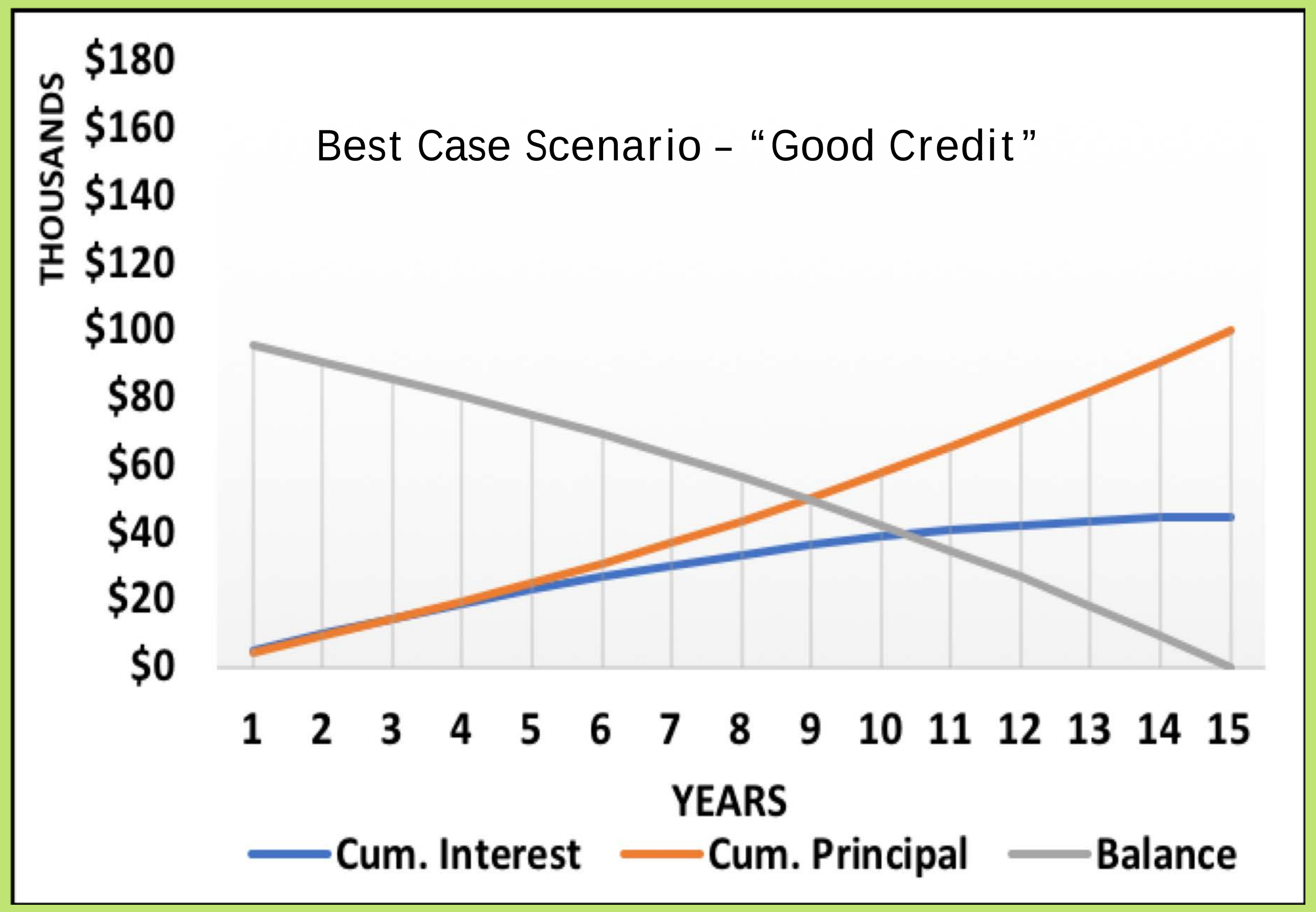
	FIXED		VARIABLE	
	High	Low	High	Low
Resident Grad/Undergrad	12.99%	5.24%	18%	4.11%
Resident Refinanced	8.24%	3.25%	9.24%	4.49%
Non-resident Grad/Undergrad	12.99%	5.24%	18%	4.11%
Non-Resident Refinanced	8.24%	8.24%	9.24%	4.49%

Table 1: Education Private Loan Rates
*Although resident & non-resident interest rates were the same, a distinction had to be made due to the higher tuition dollar amount non-resident students are forced to pay
* Data was collected from://wfefs.wellsfargo.com/terms/todays_rates.jsp

Fixed APR

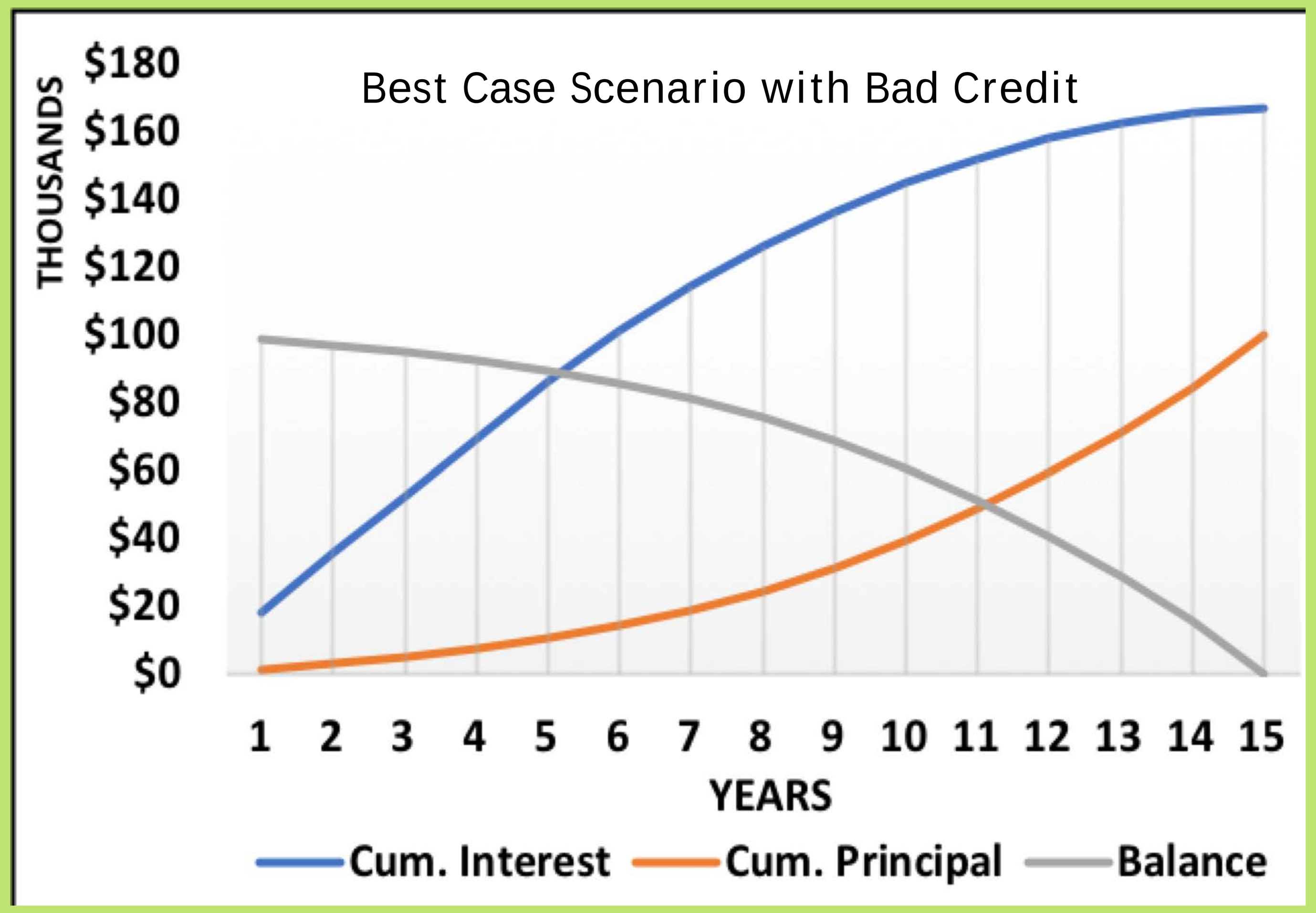


-Bad Credit: Has an APR of 12.99%, with a cumulative interest of ~$127,000 and final payoff amount of ~$227,000 on a $100,000 loan.

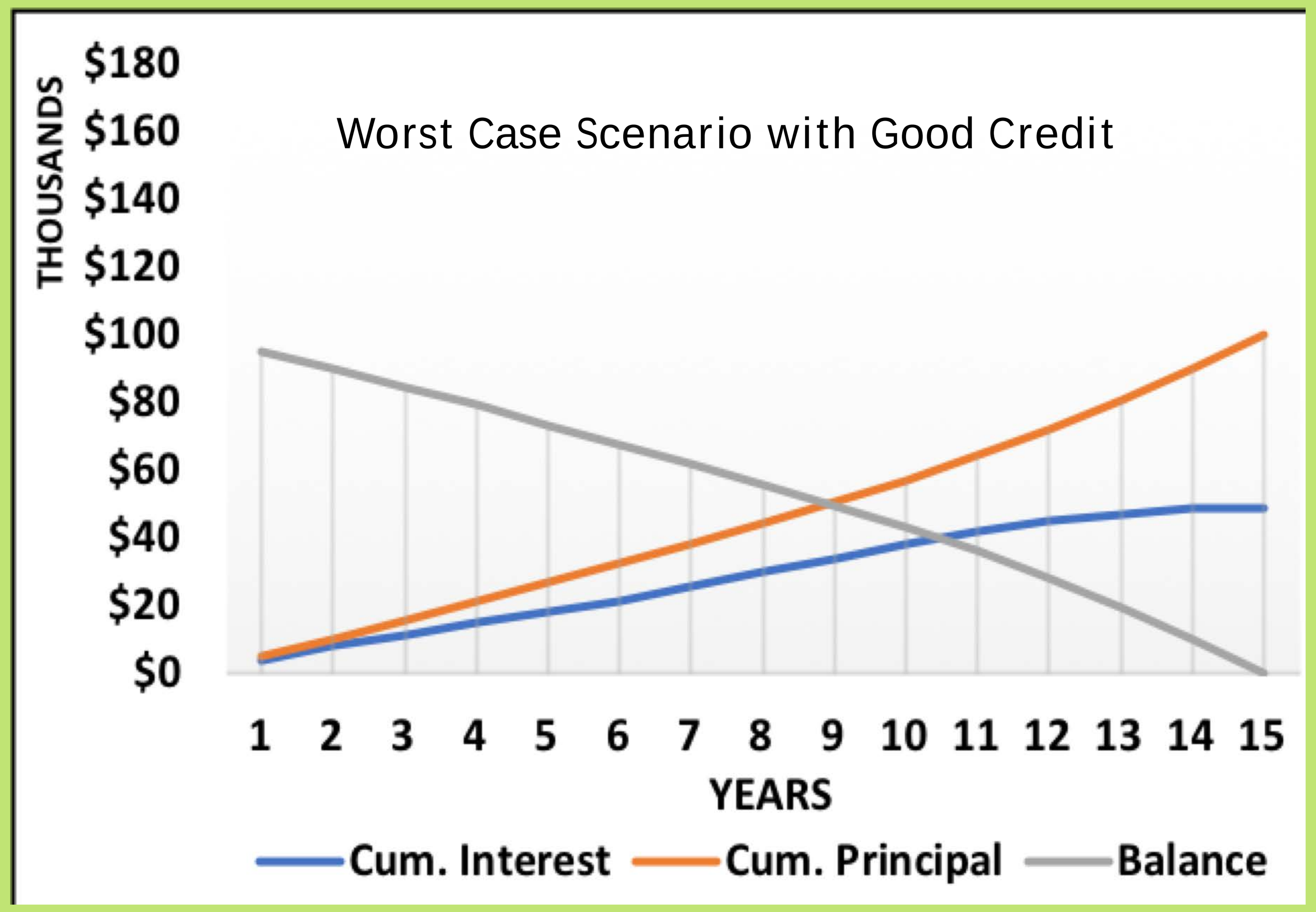


- Good Credit: Has an APR of 5.24%, with a cumulative interest of ~$44,000 and a final payoff amount of ~$144,000 on the same loan.

Variable APR



- Bad Credit: Has an APR of 18% decreasing by 1% for 5 years, with a cumulative interest of ~$177,000 and final payment of ~$277,000 on a $100,000 loan.



- Good Credit: Has an APR of 4.11% increasing by 1% for 5 years, with a cumulative interest of ~$48,000 and total payoff amount of ~$148,000.

Results

-Fixed Rate Loan: When looking into the fixed rate loan scenarios I found that the highest offered APR (worst case scenario) of 12.99% was still much lower than the 18% APR for variable rate loans. When comparing the high and low APR of fixed rate loans it gave a good idea of the window of possibilities that one could be presented with. The lowest offered APR of 5.24% on a $100,000 loan gave the borrower a total payoff amount of $144,000. The highest offered APR of 12.99% on the same $100,000 loan resulted in a total payoff amount of $227,000, a difference in total payoffs of $83,000.

- Variable Rate Loan: When looking at the variable rate loan scenarios I found that there was a much larger deviation of possible outcomes. Although I could not find a definite incremental percentage increase or decrease from lenders, I used a conservative 1% to represent the change in rate. For the highest offered APR of 18%, decreasing 1% per year for 5 years, on a $100,000 loan the student would have a total payoff amount of just over $277,000. With the lowest offered APR of 4.11%, increasing by 1% per year for 5 years, the student would have a total payoff amount of $148,000 on the same loan.

Conclusion

In conclusion, private student loans can be a very costly option. Variable rate loans could appear to be cheaper, but as shown in the study could rise over time. For those who are more sensitive to possible externalities, a fixed rate loan could be better suited. In the end, it all comes down to the borrower and their willingness to carry risk.